CalPERS
Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
Telecommunications Device for the Deaf - (916) 795-3240
(916) 795-3400

August 18, 2008

AGENDA ITEM 8a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: Member Home Loan Program Update

II. PROGRAM: Member Home Loan Program

III. RECOMMENDATION: Information Only

IV. ANALYSIS:

Member Home Loan Program Background

CalPERS Member Home Loan Program (MHLP) was created by statute in 1981. The MHLP provides real estate loans to qualified members seeking to refinance or purchase owner-occupied homes. Since the inception of the program, over 130,126 loans have been closed with a total volume exceeding $21 billion. The program is managed by CitiMortgage, Inc. Through the MHLP, first-time and repeat home buyers can take advantage of 100% financing opportunities. A common scenario involves borrowers obtaining 95% financing through the MHLP and 5% financing through CalPERS' Secured Personal Loan Program.

During the April 21, 2008 meeting, the Investment Committee asked staff to consider the prospect and potential ramifications of increasing the percentage members can borrow under the Secured Personal Loan Program from 5% to 10%. In response to this request, staff examined the following aspects of the Secured Personal Loan Program:

- Program Background and Disclosures
- Loan Delinquencies and Loan Defaults
- Consequences of Loan Defaults

Secured Personal Loan Program Background

In 1990, Assemblyman Dave Elder introduced legislation enabling members to obtain down payment funds through the Secured Personal Loan Program to purchase homes. The Secured Personal Loan Program was enacted via statute in December 1993. Under this program, members pledge up to 50% of their accumulated retirement contributions as collateral for a loan amount not to exceed the lesser of 5% of the home purchase price or $18,461. When using the Secured Personal Loan Program in conjunction with the MHLP, borrowers obtain up to 100% financing. Increasing the percentage members can borrow under the Secured Personal Loan Program would entail changing the statute.

Since the inception of the program, over 19,744 personal loans have been provided to members with a total volume exceeding $146 million.

Disclosures

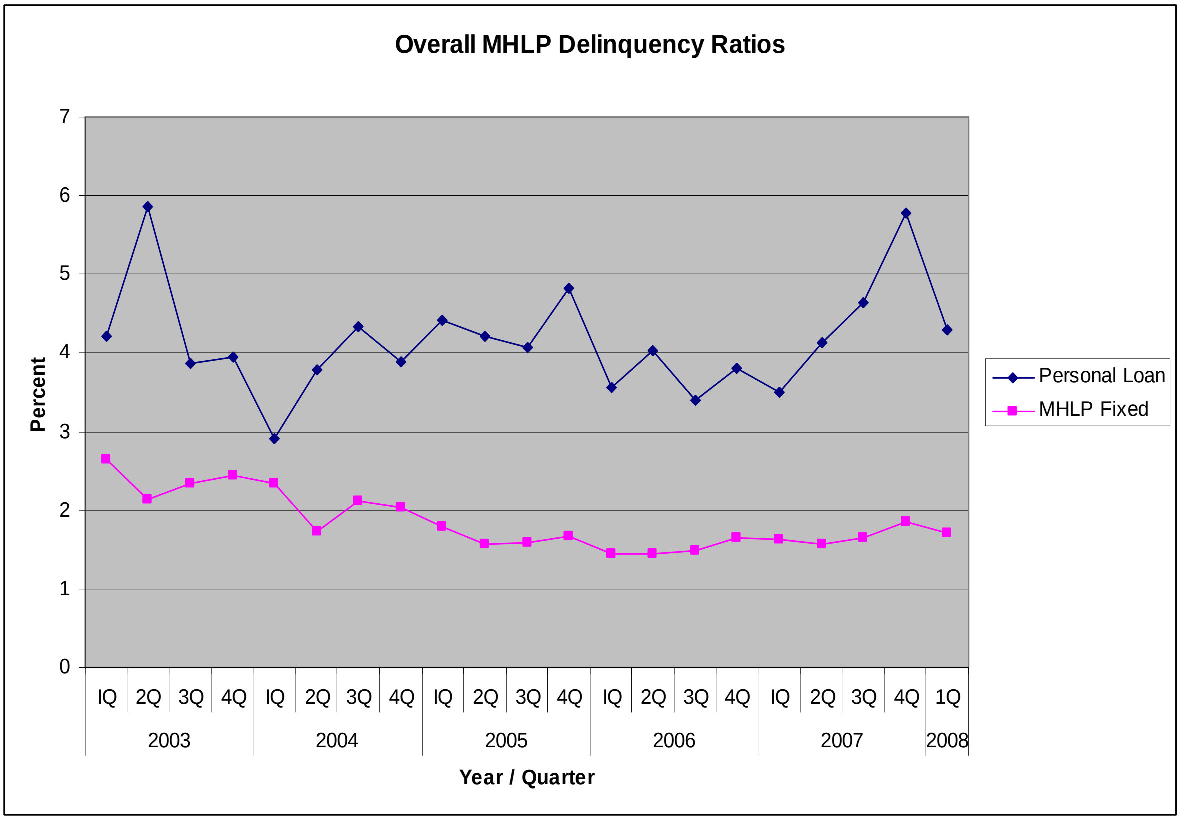
At the time of loan origination, lenders inform borrowers of the importance of timely mortgage payments and the consequences of loan default. As part of the Secured Personal Loan Program, borrowers are required to sign a promissory note, a pledge agreement, and a retirement account disclosure statement. These documents disclose that in the event of default, the member's retirement benefit may be reduced by any unpaid principal balance plus accrued interest for amounts borrowed under the Secured Personal Loan Program. Members also review and sign the same documents at loan closing.

The Promissory Note has the following language in bold print:

> **"*I have signed a Retirement Account Disclosure Statement and understand the effects on my Account of signing this Note and the Pledge Agreement. I understand that a default on this Note will reduce my retirement and/or death benefits and may have adverse tax consequences as more fully described in the Retirement Account Disclosure Statement*".**

Comparative Delinquency Statistics

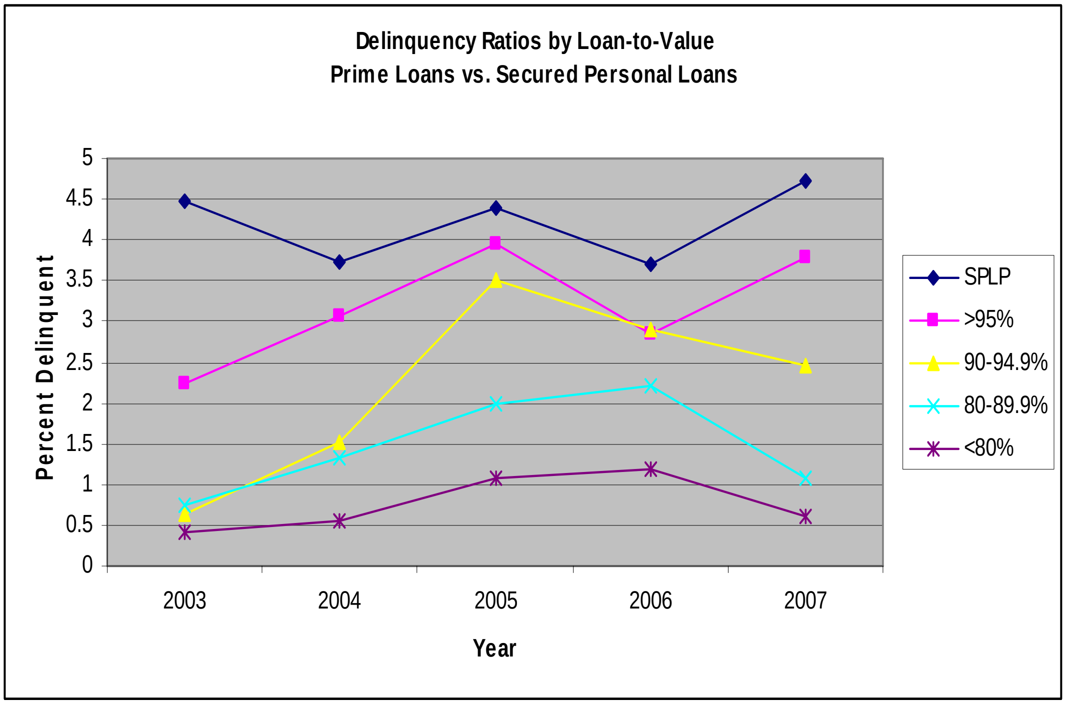
Over the last four years, delinquency ratios under the Secured Personal Loan Program were two times higher on average than those under the Member Home Loan Program. See the following graph:



Source: Member Home Loan Program Quarterly Reports to Investment Committee

Historically, borrowers using 100% financing or highly-leveraged options (like the Secured Personal Loan Program) are more likely to become delinquent on their loan payments than borrowers who have made large down payments when purchasing homes. As of June 30, 2008, 373 members were in default on their personal loans.

Industry-wide data also indicates that as loan-to-value ratios increase so do delinquency ratios. The following graph demonstrates the high correlation between high loan-to-value and delinquency ratios. It is not surprising that the Secured Personal Loan Program, with available 100% financing, has the highest default rate.



Source: JP Morgan

Loan delinquencies tend to lead to loan defaults. Since the inception of the Secured Personal Loan Program, 575 of 19,744 loans have been defaulted upon. This represents 2.9% of all loans originated under the program.

Program Risk Alternatives

Borrower delinquencies increase as loan-to-value ratios increase. Member retirement benefits are negatively impacted when members default on personal loans. Therefore, increasing the percentage members can borrow under the Secured Personal Loan Program from 5% to 10% would likely increase the risk of default and thereby the risk to member retirement benefits.

Alternative programs which offer 100% financing exist. CalPERS MHLP offers a program called ACCESS which provides down payment and closing cost assistance to qualified members. CitiMortgage markets the program to members through printed brochures, website links and via participant lenders who advise members of their home financing options. When ACCESS is used in tandem with CalPERS MHLP, borrowers may obtain financing up to 105% of the purchase price.

The primary advantage of ACCESS is that the loan is secured by the member's home and, unlike the Secured Personal Loan Program, has no effect on the member's retirement benefit. However, ACCESS loans are more costly; members incur approximately $500 of additional fees compared to the Secured

Personal Loan Program. Additionally, the ACCESS program has income limits which may prevent some members from obtaining these loans.

In summary, whereby increasing the percentage a member can borrow under the personal loan program from 5% to 10% would likely increase risk to a members retirement benefits, the ACCESS program provides members an alternative source of 100% financing without jeopardizing member benefits.

V. STRATEGIC PLAN:

Monitoring and review of CalPERS Member Home Loan Program is consistent with Goal V: Provide sustainable pension benefit products and services responsive to and valued by members, employers and stakeholders.

VI. RESULTS AND COST:

There are no costs associated with this information item.

Mark Yelavich
Investment Officer

Daniel Kiefer
Portfolio Manager

Arnold B. Phillips
Senior Portfolio Manager

Curtis D. Ishii
Senior Investment Officer

Anne Stausboll
Interim Chief Investment Officer